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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
	)	

COMMENTS OF VIRGIN ISLANDS TELEPHONE CORPORATION
ON PETITIONS FOR RECONSIDERATION

Date: August 18, 1997

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EXECUTIVE SUMMARY

Virgin Islands Telephone Corporation ("Vitelco") joins with several parties to urge the Commission to reconsider its decision to limit the federal share of the high-cost fund to only 25% of the amount necessary to ensure affordable service. The FCC's failure to establish a program that ensures sufficient universal service funding violates its obligation under the 1996 Act to establish universal service mechanisms that are "specific, predictable, and sufficient" and to ensure reasonable rates in high-cost, insular areas such as the Virgin Islands. The Virgin Islands lacks the market structure and resources necessary to generate a universal service fund capable of providing the 75% support shortfall left by the FCC. Unlike other states, the Virgin Islands has minimal vertical service offerings, has no intrastate toll service and lacks the densely-populated low-cost service areas that could otherwise be used to subsidize high-cost local service. Additional factors, such as the high cost of living in the Virgin Islands, the frequent tropical storms and hurricanes, the weak tourism-based economy still recovering from damage sustained in the past two years from Hurricanes Louis, Marilyn and Bertha, and the fact that the service area is comprised of scattered islands, all combine to drive up the cost of providing local service in the Virgin Islands. In sum, the decision to limit the federal share of the high-cost fund to only 25% will have a devastating impact on affordable service in the Virgin Islands. Moreover, this separations-related limitation was not duly considered and adopted by the Federal-State Joint Board, as required under Section 410(c) of the Communications Act.

Vitelco also agrees that the Commission should reconsider its decision to impose a cap on the recovery of corporate operations expenses that is applicable to all LECs regardless of actual expenses. This inflexible new methodology does not allow for adjustment to reflect the

considerably higher costs faced by some rural and insular LECs, including Vitelco and, therefore, will lead to higher prices in high-cost areas. By preventing recovery of these valid costs, the new rule violates the 1996 Act's requirement that the FCC must establish "sufficient" universal service support mechanisms and ensure reasonable rates in high-cost areas. Further, the Commission's decision on this matter is arbitrary, capricious and unsupported in the record and fails to explain why corporate operations expenses -- which have long been considered legitimate expenses for the purposes of the universal service fund -- should now be unrecoverable above a certain national average amount.

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To: The Commission

COMMENTS OF VIRGIN ISLANDS TELEPHONE CORPORATION
ON PETITIONS FOR RECONSIDERATION

Virgin Islands Telephone Corporation ("Vitelco") hereby submits the following comments concerning Petitions for Reconsideration submitted by various parties regarding the Federal Communications Commission's ("FCC" or "Commission") Order in the above-referenced proceeding.[1] First, Vitelco joins numerous parties in urging the Commission to reconsider its decision to limit the federal share of the high-cost fund to only 25% of the amount necessary to ensure affordable service. The FCC's failure to establish a program that ensures sufficient universal service funding violates the 1996 Act and will have a devastating impact on service in the Virgin Islands. Second, Vitelco agrees that the Commission should reconsider its decision to bar recovery of corporate operations expenses that exceed a designated cut-off based on a national average. In adopting this inflexible methodology, the FCC did not consider its impact on LECs, such as Vitelco, that face considerably higher costs of operating in remote,

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[1] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 97-157 (rel. May 8, 1997) (Report and Order) (hereinafter "*Universal Service Order*").

insular areas, as it is required to do under the 1996 Act. Therefore, for the reasons set out below, the Commission should reconsider its decision on these two issues.

I. THE COMMISSION SHOULD RECONSIDER ITS DECISION TO LIMIT THE FEDERAL SHARE OF THE HIGH-COST FUND TO 25 PERCENT

Vitelco supports the numerous parties urging the Commission to reconsider its decision to limit the federal share of universal service to 25% of the funding required to meet the interstate definition of universal service, leaving the rest to the states. *Universal Service Order*, ¶ 269. The FCC held that the federal universal service fund would provide only 25% of the difference between a carrier's forward looking economic cost of providing supported services and a to-be-determined national benchmark figure. *Id.* This decision to limit the scope of the federal universal service mechanism violates the FCC's duties under Section 254 of the Act to ensure sufficient universal service support, especially in high-cost insular areas such as the Virgin Islands, and violates the statutory requirement that the FCC address questions involving jurisdictional separations, including universal service, through a Joint Board.

A. <u>The 25% Cap Abrogates the FCC's Responsibilities Under Section 254 of the 1996 Act.</u>

The Commission's decision to curtail the federal role in ensuring universal service violates the FCC's clear statutory duty to ensure explicit and sufficient universal service, and, particularly, to ensure affordable rates in rural, high-cost and insular areas.

First, Section 254(d) requires the FCC to ensure the development of a "sufficient and predictable" federal support mechanism. Furthermore, Section 254(e) provides that "federal universal service support" -- not federal and state support in combination -- to eligible carriers must be "explicit and sufficient to achieve the purpose" of Section 254. 47 U.S.C. § 254(e). The Commission itself recognized that the 1996 Act gives it the "primary responsibility and authority to ensure that universal service mechanisms are 'specific, predictable, and sufficient.'" *Universal Service Order*, ¶ 816.[2] The decision to off-load 75% of the responsibility to ensure a "sufficient and predictable" universal service support mechanism onto the states violates this statutory duty.

Furthermore, the 25% cap will violate the requirement under Section 254(b)(3) that the FCC ensure that "consumers in all regions of the Nation, including . . . those in rural, insular, and high cost areas, should have access to telecommunications and information services . . . at rates that are reasonably comparable to rates charged for similar services in urban areas." 47 U.S.C. § 254(b)(3). By providing only 25% of the support necessary to ensure affordable service, the Commission's scheme simply cannot ensure that the rates consumers pay will be comparable from state to state, or between states and insular areas, as required by the Act.

The FCC's decision to shift the bulk of responsibility to the states and territories would leave the Virgin Islands and Vitelco adrift and would render affordable service difficult -- if not impossible -- to obtain. In fact, as a result of the exacerbating factors outlined below, Vitelco estimates that it would be forced to increase its basic residential rates by approximately 45% (to more than $26.00 per month) in order to satisfy the federal high-cost fund shortfall.

To an even greater extent than other entities which petitioned the FCC for reconsideration of this decision, the Virgin Islands lacks the market structure or the resources to generate a universal service fund capable of bearing the 75% burden left by the FCC. First, unlike other states, the Virgin Islands has minimal vertical service offerings and no intrastate toll service

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[2] *See* Vermont Public Service Board Petition, p. 3; Alaska Public Utilities Commission Petition, p. 8; Rural Telephone Coalition, pp. 3-4; Public Utility Commission of Texas, p. 2.

which could be used to generate additional funding to subsidize high-cost local service. Moreover, unlike states which may derive support for a funding mechanism through revenues earned in densely-populated, low-cost metropolitan areas, the Virgin Islands lacks sufficient low-cost areas to provide the necessary support for the remote, high-cost areas which comprise virtually the entire service territory.[3] These structural factors are compounded by economic and geographic factors which raise costs associated with providing service in the Virgin Islands, including frequent tropical storms and hurricanes, a service territory divided by water, a small customer base (fewer than 60,000 local loops), a cost of living 30% higher than the national average, and a weak tourism-based economy, which is still recovering from extensive damage caused in the past two years by Hurricanes Louis, Marilyn and Bertha. Finally, the average disposable income in the Virgin Islands is only 60% of the national average, therefore any rate increase caused by a reduction in universal service support -- especially a rate increase of 45% -- would render telephone service unaffordable for many residents and have an adverse affect on subscribership levels.[4]

Vitelco recognizes that the FCC's decision to cap the federal share of high-cost support threatens universal service in other parts of the country as well, because a number of the factors described above are common to other rural and insular regions. Several state commissions, joined by a number of local carriers, have submitted evidence that the 25% figure will shift a

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[3] *See also* US WEST Petition, pp. 3-4 ('[m]any states -- indeed, virtually all of those in US WEST's region -- lack sufficient low-cost service areas to provide the necessary supports for high-cost areas.").

[4] *See also* Puerto Rico Telephone Company Petition, pp. 7-12 (citing similar factors which raise costs in Puerto Rico and noting that a rate increase would render telephone service unaffordable for many lower-income Puerto Ricans).

tremendous burden onto the states and, without additional assistance from the federal fund, will have a debilitating impact on local rates.[5] For example, the Alaska Public Utilities Commission estimates that an additional assessment of $8.00 per access line per month would be required to recover the residual 75% contribution left to the states -- compared to an average additional assessment of $0.38 throughout the country.[6] Puerto Rico Telephone Company estimates that this loss of federal support could cause an increase in basic local rates by as much as 50%.[7]

Furthermore, even those states and territories that could establish an intrastate high-cost fund have no federal legal obligation to do so. Indeed, the 1996 Act provides that states "may" adopt additional increments to a federal support program that are "not inconsistent with the Commission's rules to preserve and advance universal service." 47 U.S.C. § 254(f). Thus, if states and territories do not establish a mechanism that provides a full 75% complement of support -- or decide (as they may, under the Act) not to adopt a mechanism to supplement the federal support program -- then carriers will be left to cope with support that is insufficient to allow the provision of universal service. Indeed, if a state or territory declines to adopt any mechanism to supplement the federal support program, as it is permitted to do under the 1996 Act, then the shortfall faced by the local exchange carrier would be staggering.

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[5] Many of these factors which would contribute to make universal service difficult in the Virgin Islands are present in other states. *See, also*, Wyoming Public Service Commission Petition, p. 2 (concluding that "twenty-five percent is completely insufficient to advance or preserve universal service in a largely rural state such as Wyoming"); Public Utilities Commission of Texas Petition, p. 2.

[6] *See* Alaska Public Utilities Commission Petition, p. 7.

[7] Puerto Rico Telephone Company Petition, p. 10.

Because only a combined fund will be sufficient to accomplish the congressional objective of nationwide parity, the Commission should reconsider its decision to establish a funding mechanism that addresses only 25% of the need for universal service support.

B. The FCC's Decision Did Not Comply With the Procedural Requirements of Section 410 of the 1996 Act.

Under the statutory scheme established to regulate telecommunications, the FCC is required to refer any proceeding regarding judicial separations to a Federal-State Joint Board to permit notice, comment and full consideration of the issues. 47 U.S.C. § 410(c). As several parties correctly noted in their petitions for reconsideration, the Commission's decision to impose this new 25% allocation cap on nationwide high cost support did not comply with this requirement under Section 410(c) and lacked the required evaluation by the Joint Board.[8] Indeed, this decision to limit the federal role fundamentally alters the Joint Board's proposal that the federal universal service mechanism be designed to provide a full 100% of necessary support.[9] Accordingly, the Commission should have referred its proposal to cap the federal share of universal service support at 25% to the Federal-State Joint Board for proper consideration in compliance with Section 410(c) of the Act.

C. The FCC's Decision Was Arbitrary and Capricious.

The decision to fund only 25% of the universal service need is not supported in the record and has no reasonable basis.[10] It appears that the FCC's rationale for its decision to limit federal

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[8] *See, e.g.*, Rural Telephone Coalition Petition, pp. 4-5.

[9] *Federal-State Joint Board on Universal Service*, 12 FCC Rcd. 87, 231 (1996) (Recommended Decision).

[10] *See* Vermont Public Service Board Petition, pp. 4-5.

universal service fund support to 25% is to mirror the current 25% loop cost allocation assigned to the interstate jurisdiction through its Part 36 separations rules. The jurisdictional allocation of loop costs, however, bears no legal or logical relevance to the amount of support required to ensure universal service.[11]

II. THE COMMISSION SHOULD NOT BAR RECOVERY OF CORPORATE OPERATIONS EXPENSES

Vitelco strongly supports the several parties that have urged the FCC to reconsider its decision to limit LECs' ability to recover Corporate Operations Expenses.[12] In the *Universal Service Order*, the FCC decided to limit the amount of corporate operations expense per line that is supported through universal service mechanisms to a maximum of 115% of the "projected level of corporate operations expense" -- a figure determined on a nationwide basis and without regard to the individual characteristics of each LEC.[13] The FCC's decision to impose a uniform, nationwide cap on these expenses violates the requirement under the Act that the FCC must ensure that rates in rural, insular and high-cost areas are comparable to those in urban areas. 47 U.S.C. § 254(b)(3). Moreover, the Commission's determination is arbitrary and capricious

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[11] *See* Public Utility Commission of Texas Petition, p. 2; Wyoming Public Service Commission Petition, p. 2.

[12] *See* 47 C.F.R. § 36.621(a)(4).

> Total Corporate Operations Expense, for purposes of calculating universal service support payments beginning January 1, 1998, shall be limited to the lesser of: (1) the actual average monthly per-line Corporate Operations Expense or (ii) a per-line amount . . . (A) [f]or study areas of 10,000 or fewer working loops; [$27.12 minus (.002 times the number of working loops)] times 1.15; (B) [f]or study areas of more than 10,000 working loops; $7.12 times 1.15, which equals $8.19.

[13] This figure was derived using a regression formula and certain nationwide cost data provided by NECA. *Universal Service Order*, ¶ 284, n. 741.

because it was made without proper consideration and without even addressing the substantial cost differences experienced by LECs, such as Vitelco, which provide service to customers in high-cost, rural and insular areas.

Corporate operations expenses have long been recognized as valid costs by the FCC and have been supported through the existing federal universal service fund pursuant to the recommendation of the Federal-State Joint Board.[14] These costs are inherent in providing local exchange and exchange access services, and are as much a part of providing universal service as the cost of network facilities. They include the costs of accounting, auditing, information management and legal services necessary for compliance with both federal and state regulations. Moreover, as several parties have recognized in this proceeding, such costs have <u>increased</u> since the enactment of the 1996 Act, making even more disturbing the FCC's decision to limit their recovery in this manner.[15] The inability to account for these actual costs would have a direct and detrimental impact on Vitelco's ability to provide universal service.

A. <u>The FCC's Rule Violates the 1996 Act.</u>

The FCC's decision to impose a national, unitary cap on permissible corporate operations expenses violates the provision under the 1996 Act that special consideration be afforded to the cost of services in rural and insular areas. Section 254(b)(3) requires the FCC to ensure that consumers in rural, insular and high-cost areas have access to services at rates that are "reasonably comparable" to rates charged in urban areas. 47 U.S.C. 254(b)(3). In order to

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[14] Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, 5 FCC Rcd 7578, 7579 (1990) (Recommended Decision and Order).

[15] *See, e.g.*, Fidelity Telephone Company Petition, p. 4; Western Alliance Petition, p. 9.

satisfy this requirement, the Commission must consider the impact of any uniform national rule on rural and insular areas -- areas where costs of providing service are substantially higher than in other parts of the country and in urban areas. The FCC failed to do so in this instance, capping the corporate operations expenses at the same level for all carriers. The impact of this rule is to deny LECs, such as Vitelco and other carriers whose corporate operations expenses and other costs far exceed the national average, the ability to account for their actual expenses.

Clearly, costs vary widely among study areas and, as the 1996 Act and the FCC have recognized again and again, carriers offering service in rural and insular areas face higher-than-average costs.[16] The costs of providing service -- including corporate operations expenses -- are considerably higher in the Virgin Islands than in other parts of the United States. For example, Vitelco had to contend with corporate operations expenses 172% higher than the national average in 1995, and 81% above the national average in 1996 -- far above the 15% deviation from the nationwide average allowed by the FCC. As explained in detail above, these higher costs are unavoidable and stem from a number of factors including the high cost of providing service to scattered islands, the high cost of living in the Virgin Islands, and the relatively small customer base. See *supra*, p. 4. Vitelco estimates that the imposition of this cap on recoverable costs would slash its high cost fund revenues by approximately $1.5 million, which would translate into a loss of support to the company's local rates of about $2 per line, per month. This result

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[16] In reaching this decision, the Commission did not acknowledge the substantial cost differences that exist among individual LECs and between regions of the country. In fact, the only distinguishing factor the FCC recognized as relevant to the level of cost support was size of study area, allowing for a higher level of corporate operations expenses on a per-line basis for smaller study areas (*i.e.*, those with 10,000 loops or fewer). While Vitelco does not disagree that the size of a study area may affect the calculation of corporate operations expenses, it strongly urges the Commission to acknowledge that there are other factors which affect cost as well.

would clearly impact the cost of service in the Virgin Islands -- yet the FCC did not even consider the impact of its rule on high-cost, rural and insular areas in rendering its decision as it was required to do under the 1996 Act.

Indeed, in this same proceeding, the FCC itself has recognized that it is often difficult, if not impossible, to compare costs faced by carriers serving urban areas and those serving insular and rural areas. For example, the Commission has explained, in addressing the use of cost models on a nationwide basis, that "[w]hile we believe that proxy models may provide an appropriate determination of costs on which to base high cost support, we are less certain that they may do so for rural carriers in Alaska and insular areas."[17] Also, the FCC recognized that the development of a special forward-looking proxy model for rural carriers would have to recognize "the unique situation" faced by carriers serving insular areas which would make selection of cost inputs for these carriers "especially challenging."[18]

Imposing a cap on corporate operations expenses, regardless of a carrier's actual costs, also violates Section 254(b)(5) of the 1996 Act, which requires that universal service support be "specific, predictable and sufficient." 47 U.S.C. § 254(b)(5). In announcing its decision to impose this nationwide cap, the FCC did not present any indication that it had considered whether its cost ceiling does, in fact, provide support "sufficient" to allow rural and insular LECs to meet their higher-than-average costs. While the FCC blithely asserted that corporate costs below its cost ceiling would be considered "reasonable," it did not explain its basis for

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[17] *Federal-State Joint Board on Universal Service*, , 12 FCC Rcd 87, 240 (1996) (Recommended Decision). *See also*, Puerto Rico Telephone Company Petition, pp. 6-7.

[18] *Universal Service Order*, ¶ 255.

concluding that a particular LEC's above-ceiling costs would necessarily be deemed "unreasonable," regardless of the LEC's unique history, market environment and actual costs.[19] Instead, the formula chosen by the FCC is to be applied on a uniform basis to all carriers, regardless of actual costs, notwithstanding that it "represents the relationship between corporate operating expenses per line for the typical community." *Universal Service Order*, n. 741.

While Vitelco agrees with the United States Telephone Association ("USTA") that the FCC should reconsider its decision to deny full recovery of corporate operating expenses, the solution proposed by USTA protects only the smallest LECs. In its Petition for Reconsideration filed on July 17, 1997, USTA argued that precluding full recovery of corporate operations expenses would represent, for some carriers, "dramatic decreases in the level of [universal service] support" and would "severely threaten these carriers' ability to provide affordable service."[20] The solution urged by USTA -- to allow a minimum of $300,000 corporate operations expenses for all LECs -- would provide no relief to mid-sized rural and insular LECs whose costs exceed the FCC's arbitrary cost ceiling.[21]

B. The FCC's Decisionmaking Does Not Comply With the APA.

The FCC's decision to select a national "average" corporate operating expense amount and allow only a 15 % deviation from this level was arbitrary, capricious and not based on

[19] Vitelco agrees with the Western Alliance's conclusion that the mathematical formula employed by the FCC to set the 115 % cut-off level does not accurately or equitably measure "reasonableness": "the location of a particular small LEC's data point above or below the . . . regression line is a function of its own specific history and environment, and indicates nothing regarding the 'reasonableness' of such expenses." *See* Western Alliance at 10.

[20] USTA Petition, p. 10.

[21] *Id.*, pp. 10-11; *see also* GVNW Petition, p.12.

reasoned decisionmaking as required by the Administrative Procedures Act.[22] In particular, the FCC's determination that corporate expenses above the 115 % cut-off are "not necessary for the provision of universal service" is unsupported by the record in this proceeding and represents a stark change of course by the Commission. As noted above, these costs have long been considered valid expenses for the purposes of the FCC's universal service fund. *See supra*, p. 8. The FCC now concludes, without explanation, that "[t]hese [corporate operations] expenses do not appear to be costs inherent in providing telecommunications services, but rather <u>may</u> result from managerial priorities and discretionary spending." *Universal Service Order*, ¶ 283 (emphasis added). Even if this conclusion is accepted as true, the Commission did not explain why all "discretionary spending" is "not necessary for the provision of universal service," or why such spending must be capped at 115% of a national average figure.

C. <u>The Waiver Procedure Does Not Protect Rural and Insular LECs.</u>

While the *Universal Service Order* allows for grant study area waivers, they are apparently available in only such limited circumstances as to effectively render such relief unobtainable and inadequate to address the serious concerns set forth above. In establishing its waiver policy, the FCC explained that universal service support may be used only for the "provision, maintenance, and upgrading of facilities and services for which the support is intended," but concluded that corporate operational expenses above the 115 % cut-off "are not necessary for the provision of universal service." *Universal Service Order*, ¶ 285. For the reasons outlined above, this provision -- whether it creates an outright ban on recovery of costs

[22] 5 U.S.C. § 706(2)(A);

above the 115 % cut-off, or simply a strong presumption against recovery -- is inconsistent with the 1996 Act.

CONCLUSION

In light of the foregoing arguments, Vitelco urges the Commission to reconsider its decisions to limit the federal share of universal service to 25% of the funding required to meet the interstate definition of universal service and to bar recovery of corporate operations expenses that exceed a cap set at 115% of a nationwide average figure.

Respectfully submitted,

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